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No. 93-567

In the Supreme Court of the United States

OCTOBER TERM, 1993

CONTINENTAL ILLINOIS CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

DREW S. DAYS, III
Solicitor General

MICHAEL L. PAUP
Acting Assistant Attorney General

DAVID ENGLISH CARMACK
CHARLES BRICKEN
Attorneys

Department of Justice
Washington, D.C. 20530
(202) 514-2217

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QUESTION PRESENTED

Whether the Commissioner of Internal Revenue abused his discretion in determining, on the facts of this case, that petitioner's method of accounting for payments of "excess" interest that were received from borrowers on "CAP loans" did not clearly reflect petitioner's income.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-15a) is reported at 998 F.2d 513. The opinion of the Tax Court (Pet. App. 16a-48a) is unofficially reported at 58 T.C.M. (CCH) 790.

JURISDICTION

The judgment of the court of appeals was entered on July 9, 1993. The petition for a writ of certiorari was filed on October 7, 1993. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. During the 1970's, petitioner made what are known as "CAP loans" to creditworthy corporate borrowers.[1] Such loans typically had fixed terms of from five to ten years and required periodic payments of interest on the outstanding principal at a floating rate determined either (i) as a percentage of the prime rate from time to time in effect or (ii) as an interest point spread above the prime rate (Pet. App. 13a, 19a). In addition to providing for payments of interest at a floating rate, CAP loans also provided that the total amount of the interest paid by the borrower over the life of the loan would not exceed the amount the borrower would have paid if the interest were calculated instead at some fixed rate to which the parties agreed (the CAP rate). A CAP loan agreement typically provided that, if the loan were repaid in due course at maturity, petitioner would refund to the borrower the amount, if any, by which the total of the interest payments made at the floating rate over the life of the loan exceeded the amount of the interest computed using the agreed CAP rate. Under these agreements, however, no refund would be made if the borrower (i) defaulted on any of its obligations under the loan agreement or (ii) repaid the outstanding principal amount of the loan before maturity (*id.* at 13a, 19a-20a). In some instances, petitioner waived its right to retain excess interest when the borrower restructured a CAP loan (*id.* at 22a).

The dispute in this case centers on petitioner's manner of accounting for and reporting the interest income

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[1] Petitioner is the parent company of a national bank, with which it filed consolidated federal income tax returns (Pet. 2). The term "petitioner" is used here to include, where appropriate, the subsidiary bank.

from its CAP loans for tax purposes. When the interest payment calculated at the floating rate exceeded the interest calculated at the CAP rate, petitioner reported as income only the interest calculated using the CAP rate. It did not report the "excess" interest (the amount by which the floating interest exceeded the interest calculated using the CAP rate) as income. Instead, it added the "excess" interest to a reserve account for "interest collected but not earned" (Pet. App. 13a, 20a-21a).[2]

Petitioner enjoyed the free use of all the interest paid by its CAP loan borrowers, including interest reported in the "interest collected but not earned" account. Petitioner was entitled to, and did, use the "excess" interest in its business. Petitioner was not required to pay interest on any such funds that might ultimately be refunded to the borrowers (Pet. App. 21a).

Petitioner typically set the CAP rate at 1.5 or 2 percent over the prime rate in effect when the CAP loan agreement was made (Pet. 3). Petitioner anticipated that the CAP rate would, on average, exceed the floating rate

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[2] When petitioner refunded "excess" interest to a borrower under a CAP loan agreement, the amount refunded was subtracted from the balance in the "interest collected but not earned" account (Pet. App. 22a).

When the floating interest payment was less than the interest under the CAP rate, and if a sufficient amount of excess interest previously had been added to the "interest collected but not earned" account, petitioner would report as income the amount of interest calculated using the CAP rate. Petitioner would simultaneously reduce the balance in the "interest collected but not earned" account by the amount of the interest shortfall, treating it as part of the interest income received in that period. If there was an interest shortfall, but no excess interest in the "interest collected but not earned" account, then petitioner would report as income only the amount of the floating rate interest payment (Pet. App. 13a, 21a).

over the life of each CAP loan. Contrary to petitioner's expectations, however, interest rates increased steadily during the late 1970's, with the result that petitioner received substantial amounts of "excess" interest from which it subsequently made refunds to borrowers (Pet. App. 14a).

On audit, the Commissioner determined that petitioner's manner of accounting for the interest on CAP loans did not clearly reflect its income. Under the accrual method of accounting, (i) treating part of the interest earned as a reserve for anticipated refunds (and therefore excluding it from income) was not appropriate and (ii) the amount of potential future refunds should be accrued as an expense only in the year in which the refunds become due or are made. The adjustments necessary to reflect these required accounting changes resulted in an increase in petitioner's net income for 1977-1979 of $26,010,158 (Pet. App. 24a-25a). Additional taxes were therefore due for those years.

2. The Tax Court upheld the Commissioner's determination. The court concluded that the Commissioner had not abused his discretion under Section 446(b) of the Internal Revenue Code in determining that petitioner's accounting method did not "clearly reflect income" (26 U.S.C. 446(b)). The Tax Court held that the Commissioner's determination was consistent with basic accrual accounting principles, noting that all the events required for the accrual of income were satisfied when the interest on a CAP loan became due or was paid (Pet. App. 28a-29a).[3] The court explained that "the obligation to

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[3] "Under an accrual method of accounting, income is includible in gross income when all the events have occurred which fix the right to receive such income and the amount thereof can be determined with reasonable accuracy." 26 C.F.R. 1.451-1(a).

refund excess interest upon satisfaction of the conditions set forth in the CAP Loan agreements constituted a contingent liability which had no bearing on CINB's right to receive interest payments, including that portion of those payments accounted for by CINB as excess interest" (*id.* at 29a). The court also held (*id.* at 33a-34a) that its conclusion was required by the "claim of right" doctrine enunciated in *North American Oil Consolidated* v. *Burnet*, 286 U.S. 417, 424 (1932). Since the repayment obligation was contingent on future events, the receipt of the interest payment constituted income to the taxpayer under the "claim of right" doctrine (Pet. App. 41a).

The Tax Court thereafter denied petitioner's motion to reconsider its decision in light of this Court's subsequent opinion in *Commissioner* v. *Indianapolis Power & Light Co.*, 493 U.S. 203 (1990) (Pet. 7).

3. The court of appeals affirmed on this issue (Pet. App. 13a-15a).[4] The court noted that petitioner did not hold the excess CAP loan interest merely as a deposit, "under [an] obligation (albeit defeasible) to return it" (*id.* at 14a). Although there was a substantial likelihood that the excess interest would have to be repaid, there was also a possibility under the CAP agreements that it would not. The court concluded, in these circumstances, that the Commissioner did not abuse his discretion in requiring petitioner to report the excess interest as income when it was received (*id.* at 15a). The court noted that "income does not cease to be such because there is some likelihood that the recipient may have to give it back. For there is always *some* likelihood of that" (*id.* at 14a).

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[4] The court also addressed several other issues, none of which is presented for review in the petition.

ARGUMENT

The decision below is correct and does not conflict with any decision of this Court or any other court of appeals. Further review is therefore not warranted.

1. a. In order to clearly reflect petitioner's income, the Commissioner determined that petitioner (i) must report all the interest it earned on CAP loans as income in the year the interest accrued or was received and (ii) could not deduct or exclude the amount of any such interest in excess of the CAP rate until the year that the obligation to make a refund became fixed. That determination represents a correct application of well-established rules of tax accounting and constitutes a proper exercise of the Commissioner's discretion.

Section 446(b) of the Internal Revenue Code authorizes the Commissioner to require taxpayers to use "such method [of accounting] as, in the opinion of the Secretary, * * * clearly reflect[s] income." 26 U.S.C. 446(b). This Court has held that respondent has broad discretion in determining whether an accounting method clearly reflects income (*Thor Power Tool Co.* v. *Commissioner*, 439 U.S. 522, 532-533 (1979)):

> In construing § 446 and its predecessors, the Court has held that "[t]he Commissioner has broad powers in determining whether accounting methods used by a taxpayer clearly reflect income." *Commissioner* v. *Hansen*, 360 U.S. 446, 467 (1959). Since the Commissioner has "[m]uch latitude for discretion," his interpretation of the statute's clear-reflection standard "should not be interfered with unless clearly unlawful." *Lucas* v. *American Code Co.*, 280 U.S. 445, 449 (1930). To the same effect are *United States* v. *Catto*, 384 U.S. 102, 114 (1966); *Schlude* v. *Commissioner*, 372 U.S. 128, 133-134 (1963); *American Au-*

tomobile Assn. v. *United States*, 367 U.S. 687, 697-698 (1961); *Automobiie Club of Michigan* v. *Commissioner*, 353 U.S. 180, 189-190 (1957); *Brown* v. *Helvering*, 291 U.S. 193, 203 (1934).

The regulations under Section 446 further expressly provide that "no method of accounting is acceptable unless, in the opinion of the Commissioner, it clearly reflects income." 26 C.F.R. 1.446-1(a)(2). "It is not the province of the court to weigh and determine the relative merits of systems of accounting." *United States* v. *Catto*, 384 U.S. 102, 114 (1966). The Commissioner's determination as to whether an accounting method clearly reflects income must be upheld "unless clearly unlawful" (*Thor Power Tool Co.* v. *Commissioner*, 439 U.S. at 532-533). The court's task "is not to determine whether in its own opinion [petitioner's] method of accounting * * * 'clearly reflect[ed] income,' but to determine whether there is an adequate basis in law for the Commissioner's conclusion that it did not." *RCA Corp.* v. *United States*, 664 F.2d 881, 886 (2d Cir. 1981), cert. denied, 457 U.S. 1133 (1982). The Commissioner's determination in this case plainly rests upon "an adequate basis in law" (*ibid.*).

Petitioner uses the accrual method of accounting. Under that method, gross income for the taxable year includes all items of income for which (i) all events have occurred that fix the right to receive the income and (ii) the amount of that income can be determined with reasonable accuracy. 26 C.F.R. 1.446-1(c)(1)(ii), 1.451-1(a). See *Spring City Foundry Co.* v. *Commissioner*, 292 U.S. 182, 184-185 (1934) ("[I]t is the *right* to receive and not the actual receipt that determines the inclusion of the amount in gross income. When the right to receive an amount becomes fixed, the right accrues."). In this case, as the Tax Court correctly concluded (Pet. App.

28a-29a), petitioner had the right to receive interest payments on its CAP loans determined at the floating rates provided in the CAP loan agreements. The agreements imposed no conditions on petitioner's right to receive the interest. When interest at the floating rate became due and payable, all the events had occurred that required an accrual of income (*id.* at 29a).

Under this same test, petitioner's obligation to make refunds did not become fixed until the date of each loan's maturity. If the borrower repaid the loan before maturity, or defaulted on the loan, or if the floating interest rates fell far enough below the CAP rate, no refund was due (Pet. App. 13a, 19a-20a). Petitioner was not entitled to accrue this contingent liability as a deductible business expense until "all events" had occurred to fix the liability. See *United States* v. *General Dynamics Corp.*, 481 U.S. 239, 243 (1987); 26 C.F.R. 1.446-1(c)(1)(ii), 1.461-1(a)(2).[5] Since the CAP loans at issue had not matured, the events fixing petitioner's liability had not yet occurred. The amount of the prospective refunds was therefore not deductible during the years in issue.

That conclusion is also required by this Court's venerable decision in the closely analogous case of *Brown* v. *Helvering*, 291 U.S. 193 (1934). As general agent for fire insurance companies, Brown received "overriding commissions" on net premiums from policies written

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[5] Section 91(a) of the Tax Reform Act of 1984, Pub. L. No. 98-369, Div. A, 98 Stat. 598, added, *inter alia*, a new Section 461(h) to the Internal Revenue Code, 26 U.S.C. 461(h) (Supp. II 1984). That Section supplemented the "all events" test for determining when an accrual method taxpayer may accrue and deduct a loss or expense by adding the requirement that any "economic performance" with respect to the item must have been completed. *Ibid.* That additional requirement does not apply to years prior to 1984 and is not at issue in this case.

through local agents. When a policy was cancelled, however, Brown was required to refund a portion of the commission he had received. Brown created an account in which he recorded an estimate of his liability to refund commissions in the event of policy cancellations, and he sought to reduce the amount of his commission income for each year by the amount of his projected liability to refund a portion of that year's commissions. The Court upheld the Commissioner's disallowance of the claimed deductions (*id* at 199; emphasis added, citation omitted):

> The overriding commissions were gross income of the year in which they were receivable. As to each such commission there arose the obligation—a contingent liability—to return a proportionate part in case of cancellation. *But the mere fact that some portion of it might have to be refunded in some future year in the event of cancellation or reinsurance did not affect its quality as income.* * * * When received, the general agent's right to it was absolute. It was under no restriction, contractual or otherwise, as to its disposition, use or enjoyment.

The Court recognized that a liability could accrue, and be treated as a deductible expense, even though payment was not yet due. It emphasized, however, that a *contingent* liability is not accruable for tax purposes (*id.* at 200):

> But no liability accrues during the taxable year on account of cancellations which it is expected may occur in future years, since the events necessary to create the liability do not occur during the taxable year. Except as otherwise specifically provided by statute, a liability does not accrue as long as it remains contingent.

The parallels between this case and *Brown* are clear. In particular, *Brown* demonstrates that petitioner errs in its heavy reliance (Pet. i, 6, 9, 12, 18) on the fact that it had no control over the contingencies on which its obligation to refund depended. The taxpayer in *Brown* also had no control over whether policy holders would choose to cancel their insurance policies, yet the Court held that he could not reduce his income by his projected contingent refund liability. The facts in *Brown*, if anything, weighed more heavily in the taxpayer's favor, for in *Brown* there was a "strong probability that many of the policies written during the taxable year [would] be cancelled" (291 U.S. at 201). By contrast, in this case, petitioner expected, at the time the CAP loan agreements were made, that it would not have to refund a substantial amount of interest in excess of the CAP rate (Pet. App. 14a). As interest rates rose, petitioner evidently perceived that it could well be required to refund some excess interest on its earlier CAP loans, and petitioner took the seemingly prudent measure of creating an accounting reserve for the payment of refunds. Creating a reserve based on the likely occurrence of particular events in the future "may be an appropriate conservative accounting measure, but does not warrant a tax deduction." *United States* v. *General Dynamics Corp.*, 481 U.S. at 246.

Petitioner's expectation that the conditions for refund would be satisfied in the future does not permit accrual of the anticipated refunds as a currently deductible expense. As this Court explained in *United States* v. *Hughes Properties, Inc.*, 476 U.S. 593 (1986), an expense does not accrue until all the preconditions for the obligation actually have been met (*id.* at 600-601):

> The Court's cases have emphasized that "a liability does not accrue as long as it remains contingent." *Brown* v. *Helvering*, 291 U.S. 193, 200 (1934); *accord*, *Dixie Pine Products Co.* v. *Commissioner*, 320 U.S. 516, 519 (1944). Thus, to satisfy the all-events test, a liability must be "final and definite in amount," *Security Flour Mills Co.* v. *Commissioner*, 321 U.S. 281, 287 (1944), must be "fixed and absolute," *Brown* v. *Helvering*, 291 U.S., at 201, and must be "unconditional," *Lucas* v. *North Texas Lumber Co.*, 281 U.S. 11, 13 (1930). And one may say that "the tax law requires that a deduction be deferred until 'all the events' have occurred that will make it fixed and certain." *Thor Power Tool Co.* v. *Commissioner*, 439 U.S. 522, 543 (1979).

This case, like *Brown*, involves a mere estimate of liability based on events that had not occurred before the close of the taxable year. This Court's decision in *Brown* thus unquestionably afforded an adequate legal basis for the Commissioner's determination that petitioner's accounting method did not accurately reflect its income. The Commissioner's determination was plainly not "clearly unlawful" (*Thor Power Tool Co.* v. *Commissioner*, 439 U.S. at 532-533) and was, instead, an appropriate exercise of discretion.

b. As the Tax Court explained at some length (Pet. App. 30a-41a), the conclusion that petitioner is not entitled to a current deduction for its estimated, future refund liability is also compelled by the "claim of right" doctrine described in *North American Oil Consolidated* v. *Burnet*, 286 U.S. 417, 424 (1932). Under that doctrine, "the receipt of money under a claim of right which would otherwise represent taxable income must be treated as taxable income even though the recipient may be under a

contingent obligation to return it at a later time." *Nordberg* v. *Commissioner*, 79 T.C. 655, 664 (1982), aff'd, 720 F.2d 658 (1st Cir. 1983) (Table). See also *Brown* v. *Helvering*, 291 U.S. at 199-200. In *Illinois Power Co.* v. *Commissioner*, 792 F.2d 683, 688 (7th Cir. 1986), the court explained that "[t]he underlying principle [of the 'claim of right' doctrine] is that the taxpayer is allowed to exclude from his income money received under an unequivocal contractual, statutory, or regulatory duty to repay it, so that he really is just the custodian of the money." *Id.* at 689. But when, as here, "the taxpayer's obligation to refund or rebate or otherwise repay money that he has received is contingent, the money is taxable as income to him." *Ibid.* In this case, as the Tax Court correctly concluded (Pet. App. 33a-34a), petitioner had a claim of right to all of the interest paid to it on CAP loans during the years in issue. The CAP loan agreements (including the potential refund mechanism) did not impose a restriction on petitioner's use of the funds. Since petitioner's refund obligation was contingent on future events, the claim of right doctrine applies to this case.

It does not matter, in this context, whether petitioner's position is characterized as seeking to deduct its refund reserve from recognized income or, instead, seeking to exclude it from recognition as income. The same principles apply to both issues. In *American Medical Association* v. *United States*, 887 F.2d 760 (7th Cir. 1989), the court held that the AMA could not exclude from its membership income the portion of the membership dues it received that it placed in a reserve fund to offset deficits that might occur in future years if membership dues were then insufficient to cover expenses. The court explained (*id.* at 774-775; emphasis added, footnotes omitted):

> In essence the AMA's argument concerning membership dues placed in a reserve account presents a question of income realization. The AMA argues, in effect, that it should not be required to recognize income in the current tax year where it has set aside the monies received to meet future expenses. But this is contrary to the general rule that income must be recognized when the recipient has the unrestricted right to use the funds. This is true even though the income recipient * * * may, in the future, be required to refund the money. *A taxpayer may not defer the recognition of income (or, what is virtually the same thing, anticipate a future expense) by unilaterally establishing reserve accounts to meet contingent liabilities.* Of course, if "all the events" necessary to establish the taxpayer's future liability have already occurred, * * * the current deduction of a future expense, or the deferral of income recognition, may be allowed.

2. Normal tax accounting rules and the claim of right doctrine thus both compel the conclusion that petitioner was required to recognize as income the "excess" interest it received on its CAP loans. Petitioner does not seriously urge that this conclusion is incorrect. Instead, petitioner suggests (Pet. 2, 7, 9, 11, 13, 16) that this analysis has been superseded by this Court's decision in *Commissioner* v. *Indianapolis Power & Light Co.*, 493 U.S. 203 (1990). That contention is not correct.

In *Indianapolis Power*, the Court considered whether certain payments by customers were advance payments for electricity, and therefore reportable as income, or instead were deposits that were not to be taken into income. The taxpayer in that case was an electric utility company that required certain of its less creditworthy

residential customers to pay a deposit to insure that their future electric bills would be paid. When and if the customer thereafter established good credit, the deposit would be refunded by cash or check or, at the customer's option, by applying it against future electric bills. The deposits were also refundable upon service termination, after payment of all outstanding electric bills. The taxpayer was required to pay interest on deposits that were not refunded within a specified period, and any deposit unclaimed after seven years escheated to the State. The Commissioner took the position that, because the deposits were frequently used to pay for electricity, they represented advance payments for electricity and were therefore taxable in the year of receipt.

The Court concluded in *Indianapolis Power* that whether the deposits constituted income when received turned on whether the parties' rights and obligations at the time the deposits were made were such that the taxpayer enjoyed "complete dominion" over the funds. The term "complete dominion" denoted the taxpayer's right to use the deposits without restriction and without an obligation to repay. 493 U.S. at 209. The Court held that the taxpayer in that case did not have "complete dominion" over the deposits because of the express undertaking to repay or apply them for the customers' benefit. *Id.* at 209, 212.

In concluding in *Indianapolis Power* that the taxpayer's receipt of the deposits did not represent income, the Court noted that the taxpayer lacked any "guarantee" that it would be allowed to retain the deposits. 493 U.S. at 210. Petitioner contends (Pet. 11, 17) that, under that same reasoning, its receipt of "excess" interest payments did not represent income because petitioner lacked "some guarantee that [it would] be allowed to keep the money" (493 U.S. at 210). Petitoner's

reliance on that language from the *Indianapolis Power* decision is misplaced.

Indianapolis Power held that the deposits did not represent income (as advance payments for electricity) because the taxpayer had an unconditional obligation to repay them and thus lacked "complete dominion" over them. While taxpayers have "complete dominion" over most items of income they receive, few, if any, items of income come with an indefeasible "guarantee,"[6] or with an obligation to pay interest if the funds are retained after a specified period. In context, the reference in *Indianapolis Power* to the lack of any "guarantee" that the taxpayer could retain the deposits did not literally imply that the item of income must be held indefeasibly to be subject to tax. To the contrary, that language indicates that the taxpayer must have at least some claim of right that *could* allow it to retain the funds. No other reading of this passage from *Indianapolis Power* is plausible, for the Court plainly did not purport to abandon its consistent prior decisions that require recognition as income of items held under a claim of right and that preclude recognition of merely contingent repayment obligations. See, *e.g.*, *United States* v. *Hughes Properties, Inc.*, 476 U.S. at 600-601; *Brown* v. *Helvering*, 291 U.S. at 199-200; *North American Oil Consolidated* v. *Burnet*, 286 U.S. at 424.[7]

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[6] For example, employees can be sued for the recovery of wages; shareholders can be sued for the recovery of dividends; merchants can be sued for the recovery of money paid for sales. As the court of appeals stated in this case, "income does not cease to be such because there is some likelihood that the recipient may have to give it back. For there is always *some* likelihood of that." Pet. App. 14a.

[7] Thus, in *Alexander Shokai, Inc.* v. *Commissioner*, 63 T.C.M. (CCH) 1870, 1881-1882 (1992), appeal pending, No. 93-70101 (9th

3. Petitioner errs in contending (Pet. 2, 9) that the decision in this case conflicts with *Ware* v. *Commissioner*, 906 F.2d 62, 65 (2d Cir. 1990). The taxpayer in *Ware* was a lawyer who, along with another member of his firm (Swire), earned a fee in 1981 by arranging the sale of a pharmaceutical plant in Ireland. With a view to keeping the fee for themselves, Ware and Swire concealed the transaction from their firm. A dispute arose over payment of the fee, which was deposited into escrow in Ireland in August 1981. Ware's firm subsequently learned of the transaction. The firm claimed rights to the fee and commenced suit to enforce those rights. Ware and Swire thereafter entered into an agreement selling their partnership interests back to the firm and providing for payment of half of the pharmaceutical transaction fee to the firm and half to Ware and Swire. *Id.* at 63. The pharmaceutical fee was paid out of escrow in 1982. *Id.* at 65 n.3.

The issue in *Ware* was whether the amount that Ware received from the pharmaceutical fee was part of the proceeds of the sale of his partnership share (and therefore to be treated as a capital gain under Section 741 of the Internal Revenue Code, 26 U.S.C. 741) or instead represented an "unrealized receivable" (to be treated as ordinary income under Section 751 of the Code, 26 U.S.C. 751). The fee represented part of his partnership interest only if it was income to the firm during 1981.

The court of appeals concluded that the fee represented an unrealized receivable because "the fee was held in escrow" in Ireland until its disbursment in 1982 and

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Cir.), the Tax Court concluded that the "complete dominion" language in *Indianapolis Power* distinguishes advance payments from deposits. See also *Kansas City Southern Industries* v. *Commissioner*, 98 T.C. 242, 261-262 (1992).

the firm "had no uncontested, clearly established right to the fee prior to signing the [1982] agreement." 906 F.2d at 64. The court noted that the firm had no "guarantee" during 1981 that it would receive any part of the fee. *Id.* at 65, quoting *Commissioner* v. *Indianapolis Power & Light Co.*, 493 U.S. at 210. The court of appeals agreed with the Tax Court's holding that the firm—which maintained its accounts on a cash receipts basis—had not "constructively" received the fee until the ownership of the fee was resolved by the 1982 settlement. *Id.* at 65 n.3. See *Ware* v. *Commissioner*, 57 T.C.M. (CCH) 105, 109 (1989).

Under the cash method of accounting, an item of income is "not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions." *Ware* v. *Commissioner*, 906 F.2d at 65 n.3, quoting 26 C.F.R. 1.451-2(a). Accord *Reed* v. *Commissioner*, 723 F.2d 138, 149 (1st Cir. 1983). The decision in *Ware* represents a particularized application of that general principle. The present case, by contrast, concerns the logically different problem of whether a payment that has *in fact been received* nonetheless does not constitute income. The conclusion in *Ware* that an attorney's fee is not includible in the income of a cash-basis law firm that *had not received* the fee does not conflict in any manner with the conclusion of the court of appeals in this case that the interest payments petitioner *did* receive represented income to petitioner in the years in which the payments were received.

4. Petitioner errs in claiming (Pet. 19-22) that the decision in this case creates uncertainty about the applicability of *Indianapolis Power* to ordinary commercial transactions involving refund obligations. *Indianapolis Power* holds that the receipt of funds subject to an unconditional obligation to repay is not income.

Petitioner's obligation to refund the excess interest it received on its CAP loans was contingent, not unconditional. The decision in this case properly interprets and applies this Court's numerous, consistent decisions.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

DREW S. DAYS, III
Solicitor General

MICHAEL L. PAUP
Acting Assistant Attorney General

DAVID ENGLISH CARMACK
CHARLES BRICKEN
Attorneys

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